

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF COLORADO
The Honorable A. Bruce Campbell**

In re:)	
)	
SCHWINN CYCLING AND FITNESS, INC.)	Bankruptcy Case No. 01-20293 SBB
EIN: 23-2994765)	Chapter 11
)	
Debtor.)	(Jointly Administered Under
)	Case No. 01-20292 SBB)
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)	
EXPEDITORS INTERNATIONAL OF)	
WASHINGTON, INC.,)	Adversary Proceeding No. 02-1078 ABC
)	
Plaintiff,)	
)	
v.)	
)	
THE LIQUIDATING TRUST, as transferee of)	
interests of the Estate of SCHWINN CYCLING)	
AND FITNESS, INC., Debtor,)	
)	
Defendant.)	

ORDER ON CROSS MOTIONS FOR SUMMARY JUDGMENT

The Plaintiff, Expeditors International of Washington, Inc. (“Expeditors”), filed its Complaint seeking a determination as to the validity, priority and extent of its lien, for allowance of its secured claim and for recovery of proceeds of collateral. The Debtor, one of the original defendants in this case, raised as an affirmative defense to the Complaint, the strong arm powers of the trustee afforded by 11 U.S.C. §544. This Court has jurisdiction over this matter pursuant to 28 U.S.C. §1334(b) and may hear and determine this core proceeding pursuant to 28 U.S.C. §157(b)(1) and (2)(K).

Expeditors and the remaining defendant, the Liquidating Trust (“Trust”), which succeeded to the interests of the Debtor, Schwinn Cycling and Fitness, Inc. (“Schwinn” or “Debtor”),¹ have submitted the dispute in this adversary case to the Court to be decided upon stipulated facts. The parties filed their Statement of Undisputed Facts (“Undisputed Facts”) and thereafter submitted cross motions for summary judgment. Responses and replies have been

¹This action was originally initiated by Expeditors against the Debtor and various other defendants, including the Creditors’ Committee. During the course of the litigation, the defendants other than the Debtor were dismissed and, most recently, the Committee’s liquidating plan was confirmed, thereby disbanding the Committee and the transferring the interests of the Debtor to the Liquidating Trust.

submitted as to each motion. Because the facts are undisputed, judgment may be rendered as a matter of law.

UNDISPUTED FACTS

1. Expeditors is a non-vessel owned common carrier, customs broker, warehouseman and provider of distribution and other logistics services. Debtor contracted with Expeditors to ship goods belonging to the Debtor, clear them through U.S. Customs and make the goods available to the Debtor for its business.

2. On April 8, 1998, Debtor executed and delivered to Expeditors a credit application which included a provision granting Expeditors a security interest in “any and all property of the [Debtor] (including goods and documents relating thereto) in [Expeditors’] possession, custody or control or en route (the ‘Collateral’)” to secure “any existing and future indebtedness of the [Debtor] to [Expeditors], including claims for charges, expenses or advances incurred by [Expeditors] in connection with any shipment or transaction of the [Debtor].” See Exhibit A to the Statement of Undisputed Facts. The credit application included Debtor’s acceptance of Expeditors’ Terms and Conditions of Service (Exhibit B to the Statement of Undisputed Facts) which included the following provision:

[Expeditors] shall have a general lien on any and all property (and documents relating thereto) of the [Debtor], in its possession, custody or control or en route, for all claims for charges, expenses or advances incurred by [Expeditors] in connection with any shipments of the [Debtor] . . .

3. In the ordinary course of Expeditors’ business, Expeditors obtained lawful possession, custody and control of goods belonging to the Debtor and in the documents of title with respect thereto.

4. On July 16, 2001 (“Petition Date”), the Debtor filed its Chapter 11 petition in bankruptcy.

5. Within the twenty-day period preceding the Petition Date (June 26, 2001 to July 15, 2001), Expeditors had in its possession goods and related documents of title belonging to the Debtor and having a value of no less than \$665,994.66. Those goods are more fully described in Exhibit B to Expeditors’ Proof of Claim (“Goods”). Expeditors’ Proof of Claim is Exhibit C to the Undisputed Facts.

6. Within that same twenty-day period preceding the Petition Date, in the ordinary course of business, Expeditors released possession of the Goods and their related documents of title to the Debtor for the purpose of ultimate sale or exchange of said goods and/or for loading, unloading, storing, shipping, transshipping, manufacturing, processing or otherwise dealing with said goods in a manner preliminary to their sale or exchange.

7. On and prior to the Petition Date, Expeditors held a perfected security interest in the Goods, the documents of title related thereto, and proceeds of the foregoing (collectively, the “Collateral”).

8. Expeditors originally perfected its security interest by way of its actual or constructive possession of the Goods and documents of title and/or notice to the steamship lines which physically transported the Goods for Expeditors and the Debtor. The steamship lines which physically transported the Goods for Expeditors and the Debtor each had notification at least one year before the Petition Date that Expeditors claimed a security interest in the Goods and related documents.

9. As of the Petition Date, Debtor owed Expeditors \$138,308.85 on account of unpaid invoices for U.S. Customs duties and freight charges which Expeditors advanced on the Debtor’s behalf and the security interest secured this obligation.² An additional amount of \$16,213.00 is claimed by Expeditors but disputed by the Debtor.

10. Shortly before or shortly after the Petition Date, the Debtor sold the Goods in the ordinary course of business.

11. At all times, including at and after the sale of the Goods, the Debtor’s bankruptcy estate had possession of cash proceeds of inventory in an aggregate amount of no less than the value of the Goods.

12. Expeditors did not file a UCC-1 financing statement with respect to the Collateral before the expiration of twenty (20) days after Expeditors released possession of the Goods and documents of title and made the Goods and documents of title available to the Debtor.

13. On July 19, 2001, counsel for Expeditors sent Debtor’s counsel a letter in which he advised Debtor of Expeditors’ claim in the approximate amount of \$153,000, that Expeditors held both a consensual and a carrier’s lien and that it was fully secured. Expeditors’ counsel

² Exhibit B to Expeditors’ Proof of Claim is a table of the seven (7) invoices which form the basis of Expeditors’ proof of claim. The table includes the invoice numbers, the dates of the invoices, the invoice amounts, the F.O.B. value of the goods in each shipment and of the goods perfected at the Petition Date, the perfection dates, the particular steamship line which shipped the goods for Expeditors and the method of perfection. Of the seven invoices, six were perfected by “notice to the bailee” and involved nonnegotiable documents. See UCC § 9-312(d)(2). Those six invoices represent the majority of the balance owed to Expeditors, \$151,834.35, and were secured by goods valued in the amount of \$647,054.71. The one other invoice for \$2,687.50 involved a negotiable bill issued by Hanjin Shipping Co., Ltd. (“Hanjin”). The column of Exhibit B which includes the “method of perfection” with respect to the collateral securing each invoice reads: “negotiable bill/notice to bailee.” While notice to the bailee in the case of a negotiable bill is not by itself sufficient to perfect a security interest in the negotiable bill, see UCC §§ 9-313(c)(1) and (2), the parties have stipulated at paragraph 6 of the Undisputed Facts (paragraph 5 above) that Expeditors, within the twenty-day period preceding the Petition Date, had in its possession goods and related documents of title and, in paragraph 9 of the Undisputed Facts (paragraph 8 above), that Expeditors “originally perfected its security interest by way of its actual or constructive possession of the Goods and documents of title and/or notice to steamship lines which physically transported the Goods for Expeditors and the Debtor.”

Exhibit B also includes the dates the documents/goods were made available to the Debtor. The goods/documents covered by: the first three invoices were made available to the Debtor on June 29, 2001; the next three invoices, on July 03, 2001; and the last invoice, on July 11, 2001.

acknowledged “that the automatic stay applies, as to the pre-petition portion of its charges, and Expeditors believe[d] that the Debtor is bound by 28 U.S.C. § 959 as to the post-petition charges.” Counsel further wrote: “In order to facilitate the resolution of this matter, we tender the goods to the Debtor, solely under the compulsion of the automatic stay and simultaneously request that the Debtor enter into a stipulation providing for adequate protection of Expeditors’ secured interest.”

14. Pursuant to a Stipulation and Order the Debtor had established a segregated cash collateral fund of \$250,000 (“Collateral Fund”), upon which Expeditors holds a replacement lien to the extent its lien and security interest in the Goods, documents of title and proceeds are valid and enforceable under applicable law and the terms of the Stipulation and Order itself.³

15. Other than Expeditors, no creditor of the Debtor claims a security interest or any other rights in the Collateral or the Collateral Fund.

ISSUE AND POSITIONS OF THE PARTIES

The question presented to the Court on these undisputed facts is whether Expeditors’ security interest in the Goods and any proceeds thereof remained perfected post-petition indefinitely or lapsed without the filing of a financing statement in accordance with UCC § 9-312(f), giving rise and efficacy to the strong arm avoidance powers of section 544 of the Bankruptcy Code. Expeditors asserts the trustee’s rights and powers as a hypothetical lien creditor under section 544 of the Bankruptcy Code arise “*as of the commencement of the case, . . .*” Expeditors urges the Court to find that because it held a perfected security interest on the Petition Date, its status as such was preserved as of that date and that its rights trump the Debtor’s strong arm avoidance powers under section 544 of the Bankruptcy Code.

Debtor and, now, the Liquidating Trust as successor, argues that because Expeditors did not file a financing statement as is required by UCC § 9-312(f)⁴ before the expiration of the twenty-day grace period which commenced when Expeditors made the Goods and related documents available to the Debtor, Expeditors’ perfection by possession lapsed when it relinquished possession pursuant to UCC § 9-313(d). Thus, the Debtor’s strong arm powers of Bankruptcy Code section 544 render the claim of Expeditors unsecured.⁵

³This Stipulation was entered into on May 20, 2002, some ten months after the bankruptcy case was filed. It has no bearing on the competing claims at issue in this adversary proceeding. It merely served to preserve the disputants’ relative positions in the proceeds at issue after the subject goods and documents were released by Expeditors to the Debtor and expiration of twenty days thereafter, without Expeditors filing a financing statement.

⁴The parties acknowledge that it is unclear whether the laws of Washington or Colorado apply but they agree that the relevant portions of both states’ Uniform Commercial Code are identical to the model 1999 version of the Uniform Commercial Code. Consequently, the parties and this Court cite to the model Revised Uniform Commercial Code.

⁵The parties tacitly acknowledge that under UCC § 9-317(a), an unperfected security interest in favor of Expeditors will be set aside pursuant to the debtor-in-possession’s (now, the Trust’s, as its successor) Bankruptcy Code Section 544(a)(1) strong arm powers.

APPLICABLE LAW AND ANALYSIS

The determination of the issue before the Court involves an analysis of the interplay between the Bankruptcy Code and the Uniform Commercial Code. Section 544 of the Bankruptcy Code, as Expeditors argues, triggers the strong arm powers of the trustee “*as of the commencement of the case.*” The status of Expeditors’ security interest as of the commencement of the case is determined, however, by the Uniform Commercial Code, and particularly, Revised Article 9.

The pertinent sections of Revised Article 9 are §§ 9-313(a) and (d), 9-312(f), 9-312(h), 9-310(a), 9-308(c), 9-203(f) and 9-315(c). Section 9-313(a) speaks to when a secured party can perfect a security interest in certain types of collateral by possession and provides : “Except as otherwise provided in subsection (b) of this section, a secured party may perfect a security interest in negotiable documents, goods, instruments, money, or tangible chattel paper by taking possession of the collateral.”

Section 9-313(d) governs the length of time of perfection by possession and provides: “If perfection of a security interest depends upon possession of the collateral by a secured party, perfection occurs no earlier than the time the secured party takes possession and continues only while the secured party retains possession.” Section 9-312(f) provides for temporary perfection of goods or documents made available to the debtor as follows:

A perfected security interest in a negotiable document or goods in possession of a bailee,⁶ other than one that has issued a negotiable document for the goods, remains perfected for 20 days without filing if the secured party makes available to the debtor the goods or documents representing the goods for the purpose of:

- (1) ultimate sale or exchange; or
- (2) loading, unloading, storing, shipping, transshipping, manufacturing, processing, or otherwise dealing with them in a manner preliminary to their sale or exchange.

Section 9-312(h) mandates that after the expiration of the twenty-day period specified in subsection (f) “perfection depends on compliance with this article.” Section 9-310 requires the filing of a financing statement to perfect all security interests except when perfected by other methods as specified in 9-310(b) and 9-312(b), including possession.

Revised Article 9 at section 9-308(c) further provides that a security interest is continually perfected if it is “originally perfected by one method under this article and is later perfected by another method under this article, without an intermediate period when it was unperfected.” Section 9-203(f) provides that “the attachment of a security interest in collateral gives the secured party the rights to proceeds provided by Section 9-315 . . .” Section 9-315

⁶ Revised Article 9 does not define “bailee.” Article 7 which covers Documents of Title, however, does. Section 7-102 defines “bailee” to mean “the person who by a warehouse receipt, bill of lading, or other document of title acknowledges possession of goods and contracts to deliver them.” The Official Comment to that section explains that the term “bailee,” not previously defined in Article 7 either, is used “as a blanket term to designate carriers, warehousemen and others who normally issue documents of title on the basis of goods which they have received.”

governs the rights of secured parties on disposition of collateral and in proceeds. The pertinent sections of 9-315 are as follows:

- (a) Except as otherwise provided in this article and in Section 2-403(2)⁷:
 - (1) a security interest . . . continues in collateral notwithstanding sale, lease, license, or exchange, or other disposition thereof unless the secured party authorized the disposition free of the security interest . . .; and
 - (2) a security interest attaches to any identifiable proceeds of collateral. . . .
- (c) A security interest in proceeds is a perfected security interest if the security interest in the original collateral was perfected.

Within the twenty-day period preceding the Petition Date, Expeditors through its bailee had the Goods and the related documents of title, including a negotiable document, in its possession, and they were of a value of no less than \$665,994.66. The Undisputed Facts of this case are that Expeditors had perfected its security interest in the Goods and related documents by such possession and by notice to the bailees. Within that same twenty-day period, however, Expeditors released possession of the Goods and the related documents of title and made them available to the Debtor for ultimate sale or exchange of said goods and/or for loading, unloading, storing, shipping, transshipping, manufacturing, processing or otherwise dealing with the goods in a manner preliminary to their sale or exchange. Thus, pursuant to sections 9-312(f) and (h), Expeditors was required to file a financing statement prior to the expiration of the twenty-day period after it released the Goods and documents to the Debtor. Had it done so, pursuant to 9-308(c), Expeditors would have held a continuously perfected security interest.

It is the corollary of 9-308(c) that is dispositive in this analysis. If there is a gap between methods of perfection, perfection is not continuous. The Official Comment to that section includes an illustration which is remarkably similar to this case:

4. Continuous Perfection. The following example illustrates the operation of subsection (c):

Example 1: Debtor, an importer, creates a security interest in goods that it imports and the documents of title that cover the goods. The secured party, Bank, takes possession of a negotiable bill of lading covering certain imported goods and thereby perfects its security interest in the bill of lading and the goods. See Sections 9-313(a), 9-312(c)(1). Bank releases the bill of lading to the debtor for the purpose of procuring the goods from the carrier and selling them.

⁷ Section 2-403 is not applicable here but reads: “Any entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business.” “Entrusting” is defined in 2-403(3) to include “any delivery and any acquiescence in retention of possession regardless of any condition expressed between the parties to the delivery or acquiescence and regardless of whether procurement of the entrusting or the possessor’s disposition of the goods have been such as to be larcenous under the criminal law.”

Under Section 9-312(f), Bank continues to have a perfected security interest in the document and goods for 20 days. Bank files a financing statement covering the collateral before the expiration of the 20-day period. Its security interest now continues perfected for as long as the filing is good.

If the successive stages of Bank's security interest succeed each other, without an intervening gap, the security interest is "perfected continuously," and the date of perfection is when the security interest first became perfected (i.e., when Bank received possession of the bill of lading). If, however, there is a gap between the stages—for example, if Bank does not file until after the expiration of the 20-day period specified in Section 9-312(f) and leaves the collateral in the debtor's possession—then, the chain is broken, the perfection is no longer continuous. The date of perfection would now be the date of filing (after expiration of the 20-day period). Bank's security interest would be "vulnerable" to any interests arising during the gap period which under Section 9-317 take priority over an unperfected security interest.

Expeditors asserts that because it was perfected on the Petition Date, its status for purposes of the debtor-in-possession's avoidance powers was then fixed for such purposes even though it did not thereafter remain perfected following the UCC § 9-312(f) grace period because it failed to file during that period. The Trust, relying on the Tenth Circuit opinion in *In re Reliance Equities, Inc.*, 966 F.2d 1338 (10th Cir. 1992), refutes Expeditors's position. In *In re Reliance Equities, Inc.*, a creditor posited the same argument, and the Court rejected it. This Court is bound and persuaded by the Circuit Court's analysis in rejecting that argument. Thus, although Expeditors was perfected pursuant to the temporary perfection provisions of Section 9-312(f) at the Petition Date, Expeditors lost that status by failing to file a financing statement within twenty days of parting with its collateral. Accordingly, the strong arm rights and powers of the trustee under Bankruptcy Code section 544 would render the unperfected security interest held by Expeditors avoidable.⁸

⁸This Court's conclusion is supported by the provisions of the Bankruptcy Code concerning the automatic stay at sections 362(b)(3) and 546(b) which give deference to the provisions of Uniform Commercial Code that are applicable here. Those sections of the Bankruptcy Code permit a secured creditor, such as Expeditors, that needs only to file a financing statement to preserve its perfection, to do so without violating the stay and, correspondingly, limit the trustee's powers under 544 to the extent a secured creditor complies with such provisions of the Uniform Commercial Code. Section 362(b)(3) creates an exception to the automatic stay for

... any act to perfect, or to maintain or continue the perfection of, an interest in property to the extent that the trustee's rights and powers are subject to such perfection under section 546(b) of this title or to the extent that such act is accomplished within the period provided under section 547(e)(2)(A) of this title. (Emphasis added)

Section 546(b), in turn, subjects the rights and powers of a trustee under sections 544 . . . of this title . . . to any generally applicable law that (A) permits perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of perfection; or (B) provides for the maintenance or continuation of perfection of an interest in property to be effective against an entity that acquires rights in such property before the date on which action is taken to effect such maintenance or continuation. (Emphasis added)

The analysis is the same with respect to proceeds. Because Expeditors failed to continuously maintain its perfected security interest in the Goods and related documents, its security interest in the proceeds thereof similarly lapsed. Sections 9-203(f) and Section 9-315(a) and (c). Accordingly, it is

ORDERED that the Trust's Motion for Summary Judgment is GRANTED; and it is

FURTHER ORDERED that Expeditors' Motion for Summary Judgment is DENIED, and its request that its claims be allowed as perfected first-priority secured claims is DENIED; and it is

FURTHER ORDERED that Expeditors' request for declaratory relief that its secured claims are not subject to avoidance under section 544 is DENIED; and it is

FURTHER ORDERED that judgment shall enter in favor of the Trust and against Expeditors, and that the relief sought in the Complaint is DENIED in its entirety; and it is

FURTHER ORDERED that Defendant Trust shall be entitled to its costs.

DATED:

BY THE COURT:

A. Bruce Campbell, Judge